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Washington, DC 20268-0001

Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products	: : :	Docket No. RM2017-3

INITIAL COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these Initial Comments pursuant to Order No. 4258. In the March 2017 round solicited by the Advance Notice of Rulemaking, Order No. 3673, GCA filed Initial Comments, to which we will refer occasionally in the present filing. GCA, which represents about 200 greeting card publishers and related enterprises, is the only postal trade association which speaks for the individual household user of the mails.

I. GENERAL INTRODUCTION

Relationship of these comments to those GCA filed in response to the Advance Notice. In Orders No. 4257 and No. 4258 (which we sometimes refer to collectively as the "December 1 Orders"), the Commission rejected some positions GCA advanced in commenting on the Advance Notice. GCA still believes that these positions are correct, and is not abandoning them; we will not, however, reiterate them here. Where we quote or refer to them, we generally do so in support of our comments on Commission findings or proposals made in the December 1 Orders.

GCA is thus not departing from our earlier view that the Postal Accountability and Enhancement Act of 2006 (PAEA) does not allow for substantial changes in the price cap or in the statutory rules governing workshare discounts (39 U.S.C. sec. 3622(e)).[1]

[1] Presented principally in sections V and VI of GCA's March 20, 2017, *Initial Comments of the Greeting Card Association..*

The same is true of our view that a market-dominant ratemaking system should not be made to solve financial problems unrelated to and unaffected by the serving of market-dominant customers.[2] In Order No. 4257, some findings as to the achievement of particular objectives also differ from positions GCA advanced in March 2017, but in those situations we will focus on problems we see in the specific proposals the Commission offers in Order No. 4258.[3]

Issues on which these Initial Comments focus. Most of the present document will focus on proposed changes to the price cap and to the workshare discount rules.

As regards the price cap, GCA believes that the proposed five-year, two percent supplemental rate authority is excessive owing to a significant omission in its design. The Postal Service's competitive products have grown in both volume and contribution, and now play a major part in maintaining its financial stability. While not totally neglected in Order No. 4258, the competitive sector is reflected only through an arbitrary assumption which is not supported by analysis, ignores relevant historical results, and will predictably lead to unnecessary and unreasonable burdens on market-dominant mailers.

Another issue regarding the relationship between the market-dominant and competitive sectors is the interaction between objective (b)(9) – appropriate allocation of institutional costs between the sectors – and the "minimum share" requirement of secs. 3633(a)(3) and 3633(b). One interpretation of objective (b)(9), which Order No. 4257 *may* have adopted – the relevant text is ambiguous – would violate established rules of statutory construction and subvert the Commission's own definition of what it has set out to do in this Docket.

While, as noted earlier, GCA still believes that the statute does not allow material changes to the workshare rules, and that in any case no changes in them are necessary

[2] See principally sections III.A. and B. of those *Initial Comments.*

[3] This is mainly because even if our view of whether a particular objective has been achieved differs from the Order No. 4257 finding, changes in a system component which did not fail to achieve the objective might still be in order if they helped achieve it better. That we suggest changes to or clarifications of a Commission proposal should not, therefore, be taken to mean that we necessarily accept an underlying finding that one or more objectives have not been achieved.

or advisable, we offer three proposals for improving the passthrough band structure proposed in Order No. 4258.

A final section discusses a few other issues which GCA considers important for a successful review of the market-dominant ratemaking system.

PRICE CAP ISSUES

This section of our comments addresses issues arising from the Commission's proposed redesign of the PAEA price cap. The Commission is on sound ground in retaining a price cap (rather than, e.g., opting for ex post "rate supervision" or some other form of deregulation). It was also a wise decision to retain the class-level structure of the cap, rather than proposing a system-wide price cap.[4] Some significant issues remain, however.

II. ORDER NO. 4258 FAILS TO REFLECT THE ROLE OF THE POSTAL SERVICE'S COMPETITIVE PRODUCTS IN ACHIEVING FINANCIAL STABILITY

A. <u>Introduction</u>

In presenting the rationale for the proposed two-percent supplemental pricing authority, the Commission starts from the Postal Service's $2.7 billion loss, recorded in FY 2017. Order No. 4258 calculates that to recover this amount over five years, the Postal Service would need two percentage points of additional rate authority, on top of the assumed 2.05-percent annual increase in the CPI-U; the result would be to place the Service "on the path" to medium-term financial stability.[5]

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[4] Changing to a system-wide cap would have hindered achievement of objective (b)(2) (predictable and stable rates) by greatly increasing the opportunity to impose widely divergent increases as among classes. For discussion, see GCA *Initial Comments,* p.12.

[5] Supplemental pricing authority is discussed generally at pp. 39 et seq. of Order No. 4258. Medium-term financial stability, as used in this Order, is measured by net income, i.e., total revenue – (attributable cost + institutional cost).

Some aspects of this proposal are, at least, not obviously unreasonable. The decision, explained at pp. 43-45 of Order No. 4258, to attempt to recover the $2.7 billion over five years rather than by a single very large (7.75 percent) increase clearly is appropriate. The remaining difficulty, inescapable because of both the nature of the Postal Service's business and the Commission's definition of medium-term financial stability, is that the two-percent supplemental rate authority would attempt to recover the entire loss from the market-dominant sector. Since it is the Postal Service as a unitary institution which the proposal seeks to make financially stable in the medium term, this is distinctly *not* reasonable. This is so because the Service’s competitive products have been, and predictably will continue to be, a very significant contributor to its financial health.

B. Order No. 4258 omits any reasoned treatment of the role of the competitive sector in Postal Service finances

Order No. 4258 mentions the role of the Postal Service's competitive products in promoting its medium term financial stability once, in a footnote on p. 41:

> [58] For purposes of determining the amount of supplemental rate authority, competitive products are assumed to maintain the current level of contribution to institutional costs. In the 10 years following the enactment of the PAEA, revenue generated from competitive products has covered those products' attributable costs and has exceeded those products' required contribution to institutional costs.

The Order makes no attempt to forecast whether that contribution will (continue to) increase during the five-year life of the proposed supplemental rate authority. It provides no justification for assuming that it will not.

GCA believes that reliance on this unsupported assumption makes the supplemental pricing authority proposal arbitrary, for several reasons:

- The assumption is clearly inconsistent with the recent history of competitive products' contribution to total institutional costs;
- It is unsupported by either reliance on expert opinion or specific analysis by the Commission;
- As a result, it conflicts with the Commission's own definition of medium-term financial stability.

We discuss these in turn. Subsequently, we describe the findings of a special study by NDP Analytics, which presents a forecast of what competitive products would actually contribute to the Postal Service's financial health.

The historical record on competitive products' contribution. The assumption that competitive products' contribution will remain constant over (at least) the next five years implies that, if the Commission in fact has considered the issue, it expects a drastic change in the behavior of the competitive sector. This expectation is not explained, and is unjustifiable in light of results recorded in the last several years.

With one relatively minor exception (FY 2011), competitive products have contributed more dollars to institutional costs every year since FY 2010, as reported in the Postal Service's annual compliance filings and the Commission's *Annual Compliance Determination Reports:*

Table A. Competitive Contribution	
Fiscal Year	Contribution ($ billions)
2010	2.420
2011	2.310
2012	3.043
2013	3.899
2014	4.310
2015	4.511
2016	5.997
2017	7.152

Order No. 4258 does not explain why a revenue element which has experienced year-to-year increases of, e.g., 19 percent (FY 2017 vs. FY 2016), or 33 percent (FY 2016 vs. FY 2015) should suddenly level off.

Absolute dollar contribution is not the only, nor perhaps even the most important[6], measure of competitive products' importance to the Postal Service's financial health. The statute (sec. 3633(a)(3)) and the Commission's rules[7] emphasize the *share* of total institutional costs contributed by the competitive sector. Here again, the history is one of essentially steady increase:

Table B. Competitive Products' Share		
Fiscal Year	Contribution Share (%)	Percent Change from Previous Year
2010	7.1	
2011	7.8	+9.86%
2012	7.4	-5.13%
2013	11.7	+58.11%
2014	12.9	+10.26%
2015	13.3	+3.10%
2016	16.5	+24.06%
2017	23.2	+40.61%

With one exception (FY 2012), competitive products' contribution as a share of total institutional costs has increased every year since FY 2010. In FY 2013, FY 2014, FY 2016, and FY 2017, there were double-digit increases.

To assume, without a word of explanation or reference to any analytical investigation, that these almost uninterrupted increases will suddenly stop, and competitive

[6] In the unlikely event that total institutional costs were to increase faster than competitive products' contribution to them, absolute dollar contribution by those products would be less relevant than whether that contribution was holding steady or increasing as a percentage of the total.

[7] 39 CFR sec. 3015.7(c).

contribution will remain frozen for five years, without regard to reasonably anticipated growth in the package delivery market, is arbitrary.[8]

The constant-contribution assumption is unsupported by either expert opinion or original analysis. The Commission presents its assumption that competitive sector contribution will not change for five years without referring to the opinion of experts or an analysis of its own. This contrasts significantly with its treatment of other prediction-dependent factors.

The Commission's rationale for the five-year supplemental pricing authority requires attention to several foreseeable developments. One highly important one is inflation (change in CPI-U). Here, Order No. 4258 relies on a – or, better, *the* – recognized authority. At p. 44, fn. 61 the Commission, referring to its assumption of 2.05 percent annual increase in CPI-U, says:

> [61] This is consistent with the medium-term forecast by the Bureau of Labor Statistics. Bureau of Labor Statistics Employment and Economic Projections for 2016 to 2026 (as of October 2017), Excel file "historicmacro.xls," tab 1, row 40, available at *https://www.bls.gov/emp/ep_data_aggregate_economy.htm.*

The obvious question is why, apparently, no similar attempt was made to find credible predictions of the future behavior, in terms of volume, revenue, and contribution, of the Postal Service's competitive products.

The Commission, in another section of Order No. 4258, did make use of historic data to determine the special rate authority needed to deal with underwater products. Pages 78-80 describe the process by which it determined – using Marketing Mail Flats as the test vehicle – that "requiring the Postal Service to increase the rate for any non-

[8] In this connection, we should note that at p. 246 of Order 4257 the Commission states that "[c]ompetitive products have generally contributed an increasing share of institutional costs each year[.]" It does not suggest any reason to think this trend will stop.

compensatory product by a minimum of 2 percentage points above the percentage increase for the class" was the appropriate remedy. To arrive at this conclusion the Commission used historic data on attributable cost increases for the product under study, assuming, first, that that cost increase rate (2.6 percent, i.e., greater than the rate of inflation) would continue, and then that it would be only 1.6 percent per year.

This detailed and fully described analysis contrasts starkly with the unexplained and unsupported assumption underlying the two-percent supplemental rate authority. Historic data on competitive products' contribution are, after all, no less available than those on attributable cost increases in Marketing Mail Flats.

Reasonably expected imprecision does not justify use of an arbitrary assumption. It might be objected that the Commission candidly, and quite reasonably, acknowledges that the supplemental rate authority is not a precision-fit cure for the Service's medium-term financial challenges. Order No. 4258 states that

> . . .Such precision is not necessary to effectuate the Commission's proposal because the proposed supplemental rate authority is not designed to provide sufficient revenue to cover costs in the same way as the revenue requirement of the Postal Reorganization Act's break-even regime. Instead, the proposed supplemental rate authority is designed to provide the opportunity to generate additional revenue that is sufficient, when combined with cost reductions and operational efficiency gains, to improve the financial stability of the Postal Service.[[9]]

It remains true, however, that the end result of the Commission's thinking is a precise number: 2.0 percent. It is that precise number which dictates the extra burden on market-dominant mailers. Since it rests on an arbitrary, and in our view almost certainly wrong, assumption, the fact that when applied in practice it may not by itself produce medium-term financial stability is irrelevant. That uncertainty, as Order No. 4258 recognizes, has many potential causes, like changes in inflation, changing input costs, or mailers' reaction to price changes. But it would be present even if the contribution of

[9] Order No. 4258, p. 41.

competitive products to financial stability had been estimated in a credible manner and recognized in designing the supplemental rate authority (which would then, in GCA's view, have amounted to substantially less than two percent[10]). That the supplemental authority alone is not guaranteed to produce financial stability does not justify designing it in an arbitrary manner.

The Commission's own definition of medium-term financial stability requires a justified estimate of competitive products' contribution to Postal Service financial health. The Commission defines medium-term financial stability as the achievement of positive net income; this, in turn, means total revenue divided by the sum of total attributable cost and total institutional cost. Findings in Order No. 4257, cited at p. 39 of Order No. 4258, led the Commission to state that "the Postal Service experienced a net loss in every year of the PAEA era as total revenue generated was inadequate to cover total costs."

That definition, by its reference to *total* revenue and *total* costs, necessarily implies that the entire Postal Service is the proper frame of reference. The "total revenue" the definition uses thus means market-dominant plus competitive revenue. This is what one would expect, since it is the Postal Service as a unitary institution[11] which should be made financially stable.

For the Commission's definition to work, total revenue must be reasonably estimated. If it is underestimated, any remedy in the form of extra pricing authority will be more drastic than it needs to be, to the needless detriment of market-dominant mailers. Such an underestimate is more than probable if, as here, the foreseeable (net) revenue from competitive products is arbitrarily frozen at current levels, regardless of a nearly continuous history of substantial annual growth, both in absolute dollars and in percentage of total institutional costs. If the Commission's concept of medium-term financial

[10] See subsection C., below.

[11] The Form 10-K reports the Postal Service files annually show that it is the whole institution whose financial condition is of interest.

stability is to be effective, that underestimate must be corrected. Otherwise, *total* revenue will not be correctly factored into the Commission's equation, and the result will not be the one the Commission is trying to achieve.

C. <u>A reasoned and fully-supported projection of competitive products' contribution</u>

Appendix A to these Comments is a report by NDP Analytics (NDP) presenting a realistic treatment of the contribution competitive products make, and can be expected to make, to the Postal Service's financial stability. Here we briefly summarize its conclusions, which are fully explained in the Appendix itself.

In analyzing the issue, NDP created two scenarios: (1) recognizing the relative shares of total revenue provided by market-dominant and competitive products – 71 percent for the former, and 29 percent for the latter – and dividing the Commission's $2.7 billion recovery proportionally between them; and (2) projecting, on conservative assumptions, the growth of competitive revenue and assessing the needed market-dominant revenue increase accordingly.

Both scenarios show that the proposed increase of market-dominant prices is unnecessarily large. The first scenario, which does not consider growth in competitive product revenue but simply recognizes the large contribution of the competitive sector, indicates that market-dominant revenues would need to increase by only about $1.9 billion, rather than $2.7 billion, because competitive products would provide the other $0.8 billion.

The second scenario reflects, as the first does not, historical trends in competitive products – but does so on two conservative assumptions: first, that competitive sector revenue will grow at only half the experienced rate (6.4 percent rather than the historical 12.9 percent), and second, that the competitive share of attributable costs will remain constant. By recognizing probable growth in the competitive sector, the second scenario projects competitive products' contribution to the $2.7 billion recovery target as $1.7 billion, leaving $1.0 billion to be covered by the market-dominant sector.

To impose an additional, unneeded $1.7 billion burden on the great majority of Postal Service customers cannot be justified in terms of the objectives of sec. 3622(b) or even of the Commission's own goals in this review proceeding. The proposed recovery mechanism should be redesigned to incorporate a proper recognition of the degree to which the Postal Service's competitive products will contribute to restoring its financial stability. The analysis in Appendix A, and particularly the second scenario just described, provide a good basis for that redesign.

D. Conclusion

The two-percent supplemental rate authority as proposed in Order No. 4258 depends on an unexplained, unsupported, and highly improbable assumption about the contribution of competitive products to the Postal Service's financial soundness. This assumption should be replaced by a fact-based forecast of competitive sector contribution and the supplemental rate authority scaled down accordingly. As it stands, it is arbitrary, and its arbitrary character undermines the supplemental rate authority structure which unavoidably depends on it.

III. ORDERS NO. 4257 AND NO. 4258 DO NOT ADEQUATELY CONSIDER THE POTENTIAL INTERACTION OF THE PROPOSED RATEMAKING SYSTEM CHANGES AND THE MINIMUM-SHARE REQUIREMENT OF SEC. 3633(a)(3)

This section discusses an issue which, though not directly connected with the price cap mechanism, could seriously affect its operation and effectiveness unless correctly resolved.

A. Outline of the issue

The issue taken up here seems to have been overlooked in the Commission's December 1 Orders. It is a potentially harmful interaction between objective (b)(9) – if interpreted wrongly – and the "minimum-share" requirement of sec. 3633(a)(3). If objective (b)(9), requiring appropriate allocation of institutional costs between the market-dominant and competitive sectors, is interpreted in one way which has been urged on the Commission[12], it would, under certain circumstances, be legally possible for the Postal Service so to price its competitive products as to burden market-dominant mailers with 100 percent of its institutional costs. That wrong interpretation treats objective (b)(9) as fully satisfied if the sec. 3633(a)(3) minimum share is being provided. But since sec. 3633(b) suggests that the minimum share could be reduced to zero percent, and some parties to Docket RM2017-1 have urged that it should be[13], the combined effect of the (erroneous) interpretation of objective (b)(9) and a zeroing-out of the minimum share would make it possible to price every competitive product at attributable cost, leaving all other costs to be paid by the market-dominant sector.

GCA of course does not expect that the Postal Service would decide to forgo the significant, and increasing, contribution it derives from its competitive products.[14] Moreover, if the Commission ultimately adopts the formula-based approach to fixing the competitive contribution share which it has proposed in Docket RM2017-1[15], reduction of that share to zero should become even more unlikely. We have outlined the potential effect of zeroing-out simply to emphasize the unreasonableness of construing objective (b)(9) as requiring no more than provision of the currently-approved minimum share. It is not only this theoretically possible result which illustrates the error in that interpreta-

[12] See, in this Docket, *Comments of the United States Postal Service* (March 20, 2017), pp. 78-79.

[13] Docket R2017-1, *Comments of Parcel Shippers Association, et al.* ("Market Dominant Mailers and Competitive Shippers"), passim; these comments were signed by ten participants. The Postal Service made a similar suggestion (*Initial Comments of the United States Postal Service,* pp. 1, 18-19).

[14] We discuss in section II, above, how this growing source of revenue should have been treated in the December 1 Orders.

[15] Order No. 4402 (February 8, 2018).

tion. That reading of objective (b)(9) also violates an elementary canon of statutory interpretation by making objective (b)(9) itself superfluous. We discuss that issue in subsection C., below, but first consider an ambiguity in Order No. 4257.

B. The Order does not present clearly the Commission's interpretation of objective (b)(9)

We do not read the relevant portion of Order No. 4257 as *necessarily* construing objective (b)(9) as requiring no more than provision of the current minimum share. The Order states that –

> . . . [T]he Commission determines that although *the mechanism* for allocation is located outside of section 3622, the statutory and regulatory mechanisms to set the allocation of institutional costs required by sections 3633(a)(3) and 3633(b) provide *a mechanism* to appropriately allocate institutional costs between competitive and market dominant products.[16]

The first clause of this sentence seems to suggest that secs. 3633(a)(3) and 3633(b) are *the* mechanism for allocating institutional costs between the sectors, which, if we assume reduction of the minimum share to zero percent, effectively allows loading of all institutional costs onto the market-dominant sector. The last clause, however, speaks of the sec. 3633 provisions as providing *a* mechanism for allocating them. This implies that there are one or more other such mechanisms, and the most obvious one is objective (b)(9).[17]

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[16] Order No. 4257, pp. 246-247 (italics added).

[17] It is not necessarily the only one. Objective (b)(8) requires establishment and maintenance of a just and reasonable rate schedule, and a schedule which required market-dominant products to pay all costs not causally assignable to any product or products would be far from just (in the sense the Commission has used that term, e.g., at Order No. 4257, pp. 113, 116 et seq.), or reasonable (in a non-technical sense).

For reasons explained below, GCA urges the Commission to resolve this ambiguity by making it clear that objective (b)(9) is not satisfied by provision of the currently-approved minimum share, and that it and the sec. 3633 provisions the Commission cites are separate and mandatory guides to allocation of institutional costs between the product sectors.

C. <u>Treating objective (b)(9) as fully satisfied by provision of the minimum share violates an elementary rule of statutory construction</u>

A statute must not be interpreted so as to make part of it redundant. It is a basic rule of statutory construction that a statute should not be interpreted in such a way as to make part of it redundant. The legislature is assumed to have intended every part of the statute to do some work not done by other parts.[18] If, as here, more than one interpretation is possible, the agency administering the statute should reject any reading which makes an element of it superfluous.

What we will call the "one mechanism" view – that which posits that objective (b)(9) is satisfied if the sec. 3633(a)(3) minimum share is being provided – violates this rule of construction.

Sec. 3633(a)(1) forbids cross-subsidization of the competitive sector by market-dominant products, and sec. 3633(a)(2) requires every competitive product to cover its attributable cost. Between them, these sections require the Postal Service's competitive products, singly and in the aggregate, to recover attributable cost *but no more.* The one-mechanism reading of objective (b)(9) necessarily implies that, if the sec. 3633(a)(3) minimum share is reduced to zero percent, objective (b)(9) itself has no more function. Under that interpretation, if the minimum competitive-sector contribution to institutional costs is fixed at zero percent, and secs. 3633(a)(1) and (a)(2) insure that

[18] See, e.g., *Corley* v. *United States,* 556 U.S. 303 (2009), *Hibbs* v. *Winn,* 542 U.S. 88 (2004); and see Order No. 4257, pp. 15 – particularly fn. 24 – and 16-17.

competitive rates precisely cover attributable cost, the “appropriate” allocation called for by objective (b)(9) has been made. There is nothing left for that objective to do.

But let us assume that the minimum share has not been reduced to zero, but, e.g., remains at the current 5.5 percent. This, however, does not make the one-mechanism view workable. In this case, it is not secs. 3633(a)(1) and (2) but sec. 3633(a)(3) which does all the work. If sec. 3633(a)(3), which underpins the 5.5 percent requirement, is the sole mechanism needed for appropriately allocating institutional cost between the sectors, objective (b)(9) has lost its function – just as it did when we assumed a zero percent minimum share, and secs. 3633(a)(1) and (2) made the allocation by themselves.

Consequently, the one-mechanism reading violates the canon against interpreting a statute so as to make one provision redundant. The Commission should reject it, and affirm that objective (b)(9) has an independent role, over and above the minimum-share requirement of sec. 3633(a)(3). There are other reasons for this conclusion, but we should first dispose of (what may seem to be) a counter-argument.

What "eliminating" the minimum share would actually do. Sec. 3633(b) allows the Commission, in its periodic reviews of the minimum share, not only to change it but to "eliminate[ ]" it. It might be argued that if the Commission does eliminate (i.e., reduce to zero percent) the minimum share, it has thereby made a judgment that competitive products should *not* contribute to institutional costs, and that if it then relied on objective (b)(9) to require some such contribution, it would be contradicting itself.

This argument, however, ignores the structure of the minimum-share mechanism. The Commission has said more than once that the minimum share is a floor to be respected, but if possible exceeded.[19] By "eliminating" the minimum share, the Commission would not be directing that competitive products' contribution *must* be zero.[20] It

[19] See, most recently, Order No. 4257, p. 245; also Docket RM2007-1, Order No. 26, ¶ 3056.

[20] Interpreting a reduction of the minimum share to zero percent as if it mandated a zero percent contribution would also hamper the Postal Service's pricing flexibility (objective (b)(4)) by effectively setting a ceiling on competitive prices and by setting what would amount to a minimum contribution (i.e., 100 percent of institutional costs) for market-dominant products.

could be deciding that, for example, the continuing growth in competitive contribution and the likelihood of its continuing to grow mean that any plausible minimum share would most probably be exceeded in practice, year after year, and thus would be a mere formality. That the Commission may eliminate the minimum share, consequently, does not mean that, if it did so, it would thereby also require that competitive products contribute nothing, and that objective (b)(9) may not be relied on to call for a non-zero contribution.

D. <u>What objective (b)(9) requires</u>

Objective (b)(9) reads:

> (9) To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

The most obvious reading of the phrase "allocate . . . between market-dominant and competitive products" is that some institutional cost is to be allocated to each sector. If 100 percent of total institutional costs is allocated to one sector and none to the other, the result is hardly an allocation *between* them. If Congress had, for example, written –

> (9) To allocate the institutional costs of the Postal Service appropriately to market-dominant products,

making no mention of the competitive sector, there might be room for the view that all those costs could, under some circumstances which it is difficult to imagine, be "appropriately" allocated to market-dominant products.[21] That is not what Congress did. The

[21] Those circumstances would be "difficult to imagine" in part because the result would certainly not be a just and reasonable schedule of rates (objective (b)(8)).

plain meaning of objective (b)(9) is that some institutional costs are to be allocated to both sectors.

E. <u>The structure and goals of the sec. 3622(d)(3) review</u>

The issue. Both the statute itself and the Commission, in Order No. 3673, define the scope of the present review: it covers all and only the components of the system of market-dominant ratemaking established under sec. 3622(a). Sec. 3622(d)(3) directs the Commission to modify the system, or provide an alternative system, "as necessary to achieve the objectives." The one-mechanism reading of objective (b)(9) would contravene this mandate.

The review is limited to the market-dominant ratemaking system. The one-mechanism interpretation necessarily affects the meaning of sec. 3633(a)(3). We pointed out above that sec. 3633(a)(3) does not make the minimum share of institutional cost to be contributed by competitive products a maximum as well. But if objective (b)(9) is interpreted as fully achieved when that minimum share is being provided, the meaning of sec. 3633(a)(3) itself has been changed. The contribution it calls for is no longer just a floor, it is also the "appropriate[ ] allocation" of institutional cost between the two product sectors which objective (b)(9) requires. Logically, if the contribution actually made exceeded the set minimum share, it would be open to attack as no longer "appropriate" – that is, too high.

In other words, by adopting the one-mechanism reading of objective (b)(9) the Commission would be changing the meaning and effect of a substantive provision outside the market-dominant ratemaking system. This it cannot do under sec. 3622(d)(3), and cannot do consistently with its own definition of the scope of this proceeding.

The Commission's observation[22] that the system has a mechanism "to appropriately allocate institutional cost between competitive and market dominant products" even though that mechanism "is located outside of Section 3622" is thus, strictly speaking, self-contradictory. The "system" as the Commission has defined it for purposes of this Docket[23], is conterminous with sec. 3622. It cannot, therefore, contain a mechanism for allocating institutional costs if that mechanism is part of sec. 3633. While sec. 3633(a)(3) and 3633(b) may do part of the job, by setting a floor under the competitive sector's contribution, they cannot be treated as the sole determinant of that allocation. The mechanism which the system *does* contain is objective (b)(9), which must therefore be accorded a role independent of the minimum share determined under sec. 3633(a)(3).

Another way to see this point is to recognize that in reviewing the market-dominant ratemaking system the Commission has undertaken to make changes, where necessary, in the mechanisms for setting *market-dominant* rates. Secs. 3633(a)(3) and (b) are not such mechanisms. Sec. 3633(a)(3) imposes a requirement on the Postal Service's administration of its competitive product prices. It is those prices – not the market-dominant rates the Service proposes annually in its R-docket filings – which produce the net revenue needed to meet the minimum share requirement.

Applying the objectives in conjunction with one another. Sec. 3622(b) requires that the objectives be applied in conjunction with one another, and the Commission has committed itself to doing so.[24] In its treatment of objective (b)(9), consequently, this review of the ratemaking system cannot rest on an interpretation which reads that objective out of the statute. We showed above (subsection C.) that the one-mechanism interpretation of objective (b)(9) in fact nullifies it. In order to achieve the objectives, the

[22] Order No. 4257, pp. 246-247.

[23] Order No. 3673, pp. 2-3.

[24] Order No. 4257, pp. 15 et seq.

Commission must recognize that (b)(9) has an independent role and is not a non-functional duplicate of sec. 3633(a)(3).

F. Conclusion

The Commission should make clear in its final order in this Docket that it rejects the view that objective (b)(9) is adequately achieved if the minimum contribution share established under secs. 3633(a)(3) and 3633(b) is being provided. It should affirm, instead, that objective (b)(9) has an independent role and may be invoked to require reallocation of institutional costs between the competitive and market-dominant sectors even if that minimum share is being contributed or exceeded.

WORKSHARE DISCOUNT ISSUES

Setting aside, for argument's sake, our view that the statute does not allow significant changes in the workshare discount provisions[25], and focusing on the Order 4258 proposals, GCA believes that the Commission's approach to reviewing the regulatory sub-system for workshare discounts is in many respects a sound one. The principle of efficient component pricing, diluted but not abandoned in the proposed rules, is still the correct basis for thinking about how to calculate workshare discounts. The proposed rules, however, do raise some issues on which clarification or reconsideration is needed.

[25] See Docket RM2017-3, *Initial Comments of the Greeting Card Association,* section VI.

IV. STATUS OF THE EXISTING STATUTORY EXCEPTIONS

Sections 3622(e)(2)(A) – (D) and (3) of PAEA qualify the avoided-cost rule of subsection (e)(2) by allowing a discount to breach it if, for example, reducing it would "impede the efficient operation of the Postal Service." (Subparagraph (e)(2)(D).) Paragraph (3) prescribes when an otherwise non-compliant discount need not be reduced. These exceptions have often been relied on by the Postal Service, and the Commission not infrequently accepts the proposed justification.[26]

Order 4258 does not state explicitly that the proposed rules supersede these statutory exceptions. This leaves it unclear whether a discount falling outside the band might still be saved by invoking one of them. As we read the proposed rule language, it appears that the Commission means to abolish the exceptions (as, in GCA's view, it should). Proposed 39 CFR sec. 3010.261 seems to negate the possibility of reliance on a statutory exception:

> (a) Except as provided in § 3010.262, *all* percentage passthroughs for workshare discounts *must be set within the bands* as specified in paragraphs (b) through (c) of this section.

(Italics added.)[27] Since this proposed rule refers specifically to one exception – the three-year grace period – and requires that otherwise all discounts must fall within a band, there would seem to be no room to argue that an exception *not* mentioned in the

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[26] For example, in the FY 2016 *Annual Compliance Determination,* the Commission accepted the Service's justifications for otherwise non-compliant discounts for First-Class Automation 5-Digit Flats (pp. 14-15), several in Periodicals (pp. 18 et seq.), Standard Mail Automation Mixed AADC Letters (pp. 24-25), Standard Mail DNDC and DSCF Dropship Letters (pp. 26-27), Standard Mail Automation Mixed ADC Flats (pp. 28-29), Standard Mail Nonprofit Mixed NDC Machinable Barcoded Parcels, Nonprofit Mixed NDC Irregular Barcoded Parcels, and Mixed NDC Barcoded Marketing Parcels (pp. 31-32), Standard Mail DNDC and DSCF Dropship Carrier Route Letters (pp. 32-34), Standard Mail High Density and Saturation DNDC and DSCF Dropship Letters (pp.34-36), and Media and Library Mail Basic Presort (pp. 36-37).

[27] The exception – sec. 3010.262 – is the three-year grace period and has no connection with the existing statutory exceptions.

rule could also apply. The more reasonable view, then, would be that the rule does eliminate the statutory exceptions.

The distinction is important if the proposed rules are to be effective in promoting achievement of objective (b)(1). If the rules do supersede the statutory exceptions, no discount exceeding 115 percent (or 125 percent in the case of Periodicals) could survive for more than three years.[28] If they do not, there is, potentially, no limit to how long a discount could remain at inefficient levels. For example, consider a discount in First Class which in year 0 incorporates a 150 percent passthrough; in year 1, 140 percent; in year 2, 135 percent; and in year 3, 130 percent. If the statutory exceptions have been done away with, that discount must then be reduced immediately to (or below) the 115 percent limit.[29] If they have not, it will be open to the affected mailers and perhaps also the Postal Service to argue that, for example, a discount passing through any less than 130 percent of avoided cost would impede efficient operation. The Commission, of course, could rule otherwise[30]; our point is that, if the proposed rules do mean that the statutory exceptions are superseded, the issue could not even arise.

Removing this ambiguity may not require changes in the proposed rule language. The Commission should, however, explain clearly in its final order that the existing statutory exceptions are no longer part of the system and may not be relied on once the new rules are in effect.

V. HOW ARE DISCOUNTS IN A MULTI-TIER CATEGORY TO BE CALCULATED?

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[28] The same would be true for discounts with passthroughs falling below 85 percent (or 75 percent) of avoided cost, though since the statute does not enact a discount floor, the statutory exceptions would not apply to them.

[29] Example: in the *Annual Compliance Determination Report* for FY 2016, at pp. 12-13, the Commission directed the Postal Service either to bring the 111.1 percent passthrough for First-Class Automation AADC Letters down to avoided cost or to justify it under a statutory exception in its next annual rate adjustment.

[30] Even then, however, the question would arise whether *another* three-year grace period would be available in which to carry out the Commission's instructions.

This issue arises because it has been common practice to construct the (ideal)[31] rate for the next-most-finely prepared cell in a multi-tier product, such as First-Class Automation Letters, by subtracting the relevant cost avoidance from the rate next above it. For instance, in Order No. 536 the Commission observed that

> . . . Use of the term "discount" in section 3622(e) implies that the workshared group's rate is defined with reference to the base group's rate. In other words, the two rates are linked.[[32]]

The difficulty is that, if applied in one possible way, the proposed band rules could generate non-compliant rates.

Here is an example, using the nomenclature of First-Class Automation Letters, but with fictitious rates and costs (so as to avoid, for the moment, the problem of real-world passthroughs not equal to 100 percent of avoided cost).

If the rate for Mixed AADC Letters is $0.40, representing a cost avoidance of $0.08 vis-à-vis Metered Letters, passed through at 100 percent, and the cost avoidance from AADC preparation is $0.07, the (ideal) AADC rate would be $0.40 - $0.07 = $0.33.

Under the proposed band structure, ambiguities could arise. Suppose that the hypothetical Mixed AADC rate is now not $0.40, but $0.388, representing a passthrough of 115 percent of the avoided cost vis-à-vis the Metered Letters benchmark. If we then proceed as above outlined, the rate for AADC letters will be based on a passthrough at the top of the band. That is, the *actual* cost avoidance for Mixed AADC Letters is, as above, $0.092 / 1.15 = $0.08, while the Mixed AADC rate appears to reflect a cost avoidance of $0.092. Suppose, further, that the AADC rate likewise includes a 115 percent passthrough of the cost saving vis-à-vis Mixed AADC. On that supposition, that AADC rate would be $0.388 – ($0.07 * 1.15) = $0.3075.[33] The total reduction reflected in the AADC rate would thus be $0.092 + $0.0805 = $0.1725, whereas the actual cost

[31] We call the result an "ideal" rate because it assumes that the passthrough for the rate being constructed will be exactly 100 percent.

[32] Docket No. RM2009-3, Order No. 536, pp. 19-20.

[33] To make the arithmetic clearer, we have ignored the rounding customary in expressing rates.

avoidance is only $0.08 + $0.07 = $0.15. That is, the AADC rate, instead of the “ideal” $0.33 calculated above, would be $0.3075. If, however, the construction of the AADC rate had started from an “ideal” Mixed AADC rate of $0.40 – thus removing from the calculation the 15 percent up-side tolerance provided by the band, insofar as it applied to Mixed AADC – it would be $0.40 - $0.0805 = $0.3195. But from this viewpoint, the AADC passthrough at the $0.3075 price would be too large: $0.40 - $0.3075 = $0.0925, as against an actual Mixed AADC vs. AADC cost avoidance of $0.07, or 132.14 percent. The maximum AADC passthrough permitted by the band structure, 115 percent, would imply, instead, an AADC rate of $0.40 – ($0.07 * 1.15) = $0.3195.

The $0.3075 result, calculated without regard to the "ideal" $0.40 Mixed AADC rate, seems inconsistent with proposed sec. 3010.261, quoted above. If all percentage passthroughs must fall within the applicable band, then the "quasi-compounding" effect just described cannot be allowed to occur. The proper procedure for constructing rates one after the other down the presort tree would seem to be to calculate an “ideal” rate for – using our example – Mixed AADC with a passthrough equal to 100 percent of avoided cost, and construct the AADC rate on that basis rather than from the rate actually selected (which might, as in the example, incorporate a passthrough of 115 percent); and this procedure would be followed even if the Postal Service had actually set the Mixed AADC rate at $0.388, implying a 115 percent passthrough of savings vis-à-vis Metered Letters.

The problem is not simply one of inconsistency with proposed rule language. The Commission has evidently decided that passthroughs greater than 115 or 125 percent, or less than 85 or 75 percent, cannot be squared with objective (b)(1). If a technique of constructing worksharing rates one after the other down the presort tree can lead to passthroughs excessive by this standard, and if that result can be avoided by requiring that each successive rate be linked to an "ideal" rate for the next-highest cell,the defective technique of starting from actual rather than “ideal” rates should be definitively excluded.[34] Again, it is not certain that this would require changes in the rule language

[34] More generally: cost avoidance is logically prior to passthrough. A “percentage passthrough” not tied to a definite cost avoidance is a meaningless expression. The suggested technique of developing the second workshared rate from an “ideal” version of the first, incorporating a 100 percent passthrough, effectively preserves this logical priority.

(though they might be helpful), but if the proposed band structure is finally adopted, the order should clearly explain that worksharing rates are to be calculated under the “ideal rate” approach described above.

VI. BANDS NEED NOT BE SYMMETRICAL AROUND AVOIDED COST

Nature of the problem. Order No. 4258 proposes bands which would allow equal deviation from avoided cost in both directions; for Periodicals, passthrough could fall below avoided cost by 25 percent, or exceed it by the same amount. For other classes, the tolerance is 15 percent for both excess and deficiency. The Order does not, however, indicate that configurations other than symmetry around avoided cost were considered. We would suggest that there are reasons to contemplate asymmetrical bands as a possibly superior arrangement.[35]

The most recent set of passthroughs, recorded in Docket R2017-1 and discussed at p. 94 of Order No. 4258, exhibited a definite tendency for passthroughs to fall below the proposed lower limit. The Commission found that of 21 non-conforming passthroughs in Periodicals, seven were above the proposed band and 14 below it. For the other classes combined, 18 non-conforming passthroughs were above the band and 37 below. While this pattern does not by itself constitute an argument against symmetrical bands, it does suggest some considerations which point in that direction.

Just as a discount smaller than avoided cost may lead to the Postal Service’s performing work which some mailers could do more cheaply, a discount greater than avoided cost unnecessarily deprives the Service of revenue. The Commission cites (Order No. 4258, p. 89, fn. 92) its observation in the FY 2016 *Annual Compliance Determination* (p. 1) that discounts exceeding avoided cost adversely affect Postal Service finances. This is so because, e.g., a discount of $0.05 for worksharing which saves $0.04 causes a loss to the Service of $0.01 per piece.

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[35] In making this suggestion, GCA is assuming for purposes of argument that the proposed band structure will in fact be established in some form. We are not abandoning our long-standing endorsement of efficient component pricing (ECP), in its theoretically correct form calling for discounts corresponding to avoided cost.

Assessing relative risk. Because Postal Service costs and revenues are a comparatively open book, we can say that this $0.01 per-piece loss is simply a matter of arithmetic. It is not so easy to assess the damage caused by a discount materially less than avoided cost. It is broadly true that it will discourage *some* mailers[36] from undertaking worksharing; the *theoretical* answer would be that a mailer would not participate if the investment necessary for the worksharing in question would not earn a competitive return at the discount offered. Much less appears to be known, however, about the real-world relationship between discounts and mailer expectations than about that between discounts and Postal Service finances. If a mailer earned a supra-competitive return from a discount set at 100 percent of avoidable cost, it might well continue to engage in worksharing even if the passthrough fell to 80 percent. This hypothetical situation is of interest because a worksharing relationship in which the mailer enjoys a supra-competitive return on its worksharing investment may not be an ideally efficient one *even if the discount passes through exactly 100 percent of the Postal Service's avoided cost.*

If situations of this kind occur in fact, they would seem most likely to occur where the mailer and the Postal Service do not use the same technologies to achieve a given result. The most evident case is barcoding.[37] If the mailer can apply a barcode in the process of creating the mailpiece, whereas the Postal Service must apply it using distinct sets of machines and labor resources, it seems possible that the difference in cost between barcoding by the mailer and barcoding by the Service will be large. And if it is, supra-competitive returns on mailers' barcoding investments, with the concomitant ability to profit from a discount passing through somewhat less than avoided cost, are a realistic prospect.

Postal Service revenue. Possibilities like this are, in GCA's view, one reason to be cautious in deciding that the proposed bands must be symmetrical around avoided

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[36] "Mailer" includes, *mutatis mutandis,* letter shops and similar third parties.

[37] J.-J. Laffont and J. Tirole, *Access Pricing and Competition* (1994) (https://archive.org/stream/access-pricingcom00laff) note (p. 23) that the ECP rule is optimal under certain assumptions, among them: "First, the monopoly's goods and the entrant's goods are perfect substitutes." This condition clearly is not met when the entrant's "good" is the application of a barcode during its creation of the mailpiece – for which no Postal Service "good" could be a substitute at all, let alone a perfect one.

cost. Another is the question of Postal Service financial stability; and, given the goals of this Docket, this is perhaps the more urgent one.

Here, it is fair to say that there is much less uncertainty about the effect of discounts which measurably exceed avoided cost. It is certain that a discount exceeding avoided cost will deprive the Service of some amount of revenue, and – given our relatively complete information about Postal Service costs – estimating the size of the loss is relatively straightforward. Because of this relative certainty, avoiding unnecessary revenue lost may be an even more compelling reason to favor adjusting the bands downward.

At p. 28 of Order No. 4258, the Commission observed that "[t]he cost reductions and operational efficiency gains experienced under the existing ratemaking system have been insufficient to contribute to the financial stability of the Postal Service." However, the discussion the proposed changes, at pp. 93 et seq. of Order No. 4258, does not include explicit consideration of objective (b)(5) (adequate revenue).

Since the Commission evidently believes that a fairly substantial range of variation from "strict" ECP (i.e., discount exactly equal to avoided cost) would sufficiently promote objective (b)(1), it would be desirable to inquire also whether that range has to be symmetrical around avoided cost. GCA would suggest that, if the Commission decides to proceed with the band structure, the bands should be "lowered" – e.g., to 65 to 115 percent for Periodicals and 75 to 105 percent for the other classes – in the interest of achieving objective (b)(5). Doing so would reduce the prevalence of discounts exceeding avoided cost, which are certain to cause needless financial loss to the Postal Service. In suggesting this, we also recognize that the effect of lowered bands on worksharing participation would have to be monitored, and that future rulemakings might be needed to adjust the bands further.[38]

E. Conclusion

[38] There would seem to be no requirement that this be done as part of a complete re-review of the entire market-dominant system, particularly if the final order in this Docket clearly reserved the power to make such adjustments.

GCA still believes that the existing rules established under sec. 3622(e) remain the best approach to regulating workshare discounts. The suggestions made in subsections (B) through (D), above, are offered on the assumption that the Commission will remain committed to some form of band structure, and are intended to make that structure, if adopted, more effective in achieving all the objectives of sec. 3622(b), including particularly the adequate revenue goal of objective (b)(5).

OTHER ISSUES

VII. DEFINING "FINANCIAL STABILITY"

In Order No. 3673, the Commission preliminarily defined financial stability:

> *Preliminary definition.* In a system achieving Objective 5, the Postal Service is financially solvent while able to respond to changes in its environment (*e.g.,* volume erosion, legal or regulatory framework, demographic trends) and meet its statutory obligations (*e.g.,* pricing and universal service).[[39]]

The December 1 Orders continue to rely on this definition.

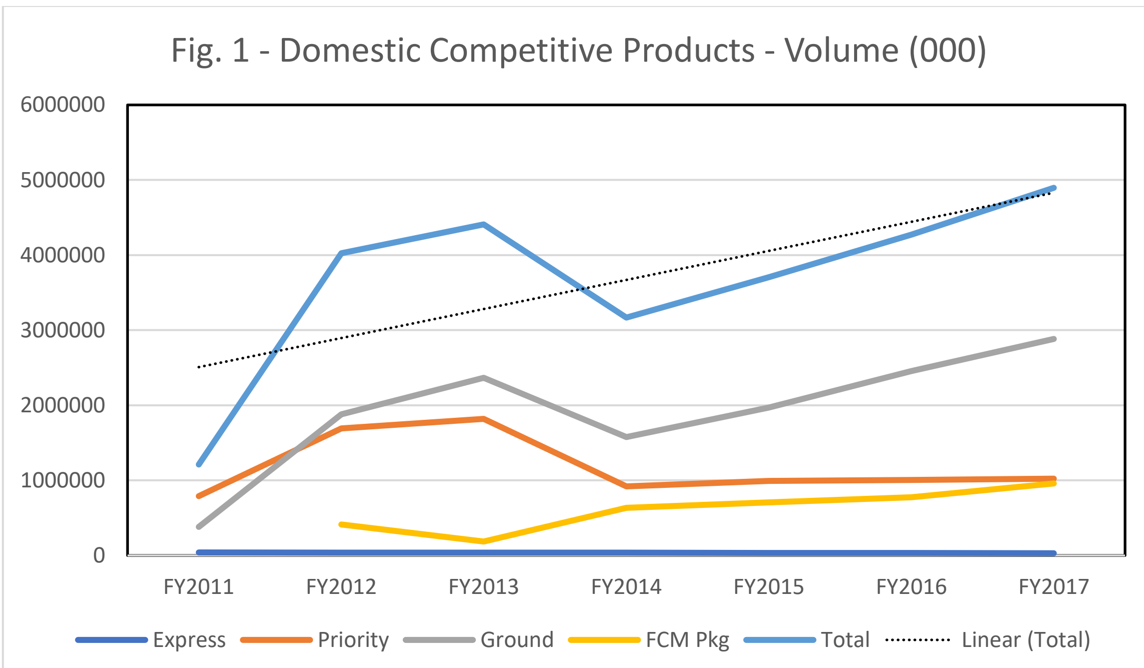
The definition, as far as it goes, is workable. In some respects, however, it needs clarification; otherwise, it may suggest initiatives which would not advance, and could very well hinder, achievement of the statutory objectives.

This issue is significant not just for this Docket but because the Commission has stated, in connection with the proposed two-percent supplemental rate authority, that it will review the medium-term financial stability situation in five years.[40] Since the definition of financial stability will presumably remain constant over that five-year span, we would suggest that it be clarified fully now.

[39] Order No. 3673, p. 7.

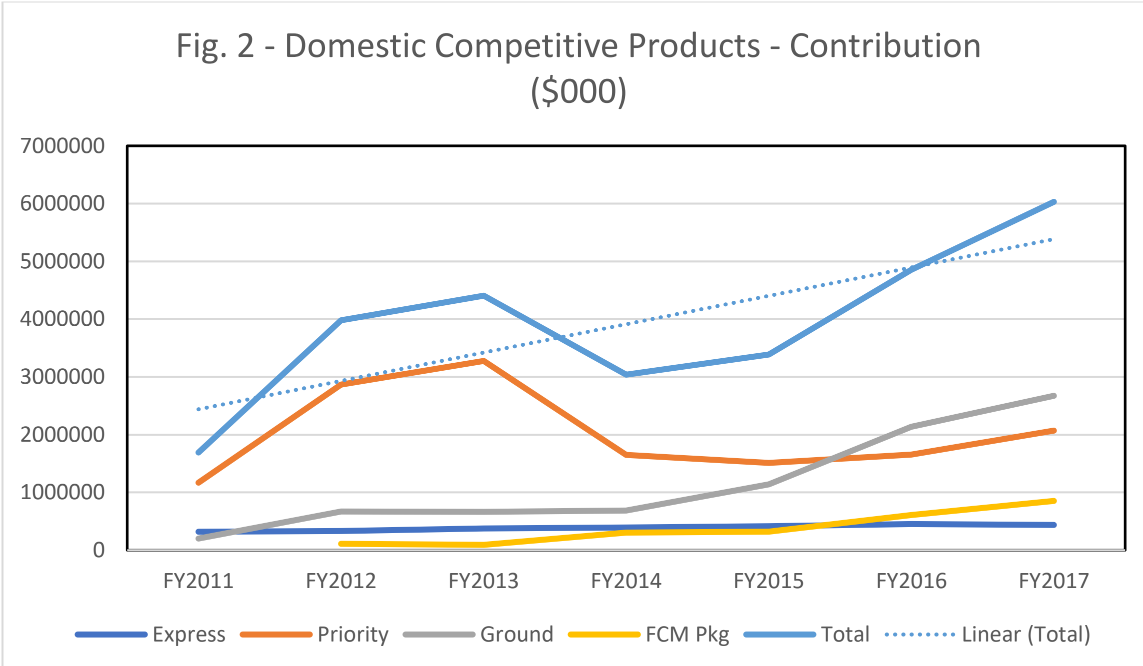
[40] Order No. 4258, p. 42.

Volume erosion. The definition is clearly correct in suggesting that volume erosion is relevant to financial stability. It does not make clear, however, that for financial evaluation what is really needed is a concept we may, somewhat loosely, call *net* volume erosion. The "financial stability" at issue this review is that of the entire Postal Service.[41] Volume, therefore, should be taken as including that of competitive as well as market-dominant products; and volume on the competitive side has been growing rather than eroding. Fig. 1, below, charts competitive volume trends since FY 2011. The "erosion" shown there was temporary. The overall trend has been upward; the trendline for total volume is shown dotted in the chart.



Since the issue is financial stability, it may be that contribution would be a better metric than volume. Here, the pattern, shown in Fig. 2, is much the same. Contribution grew, declined temporarily, and then grew again.

[41] For further discussion of this concept, see section II, above.



Again, the overall trend is upward. These trends imply that the erosion of market-dominant volume is only part of the story, so far as the Postal Service's financial stability is concerned. It would be desirable for the Commission to make clear – and to keep in mind when evaluating possible changes to the ratemaking system – that the volume erosion it is considering is a Postal-Service-wide, net phenomenon, and that its significance lies very largely in the contribution to institutional costs.[42]

Scope of the review process. We have examined the preliminary definition of financial stability in some depth in part because of an ambiguity in Order No. 4257. As regards medium-term stability, which it found had not been achieved[43], the Commission noted that

[42] That sheer volume is not the determining factor is clear if we consider underwater products, such as Periodicals (FY 2017 cost coverage less than 70 percent), where an increase in volume would leave the Service worse off financially.

[43] Order No. 4257, pp. 168-169.

> . . . [e]ven with the additional revenue received during the [exigency] surcharge period and the inclusion of the Postal Service's borrowing authority, *the total revenue generated by the market dominant ratemaking system was not sufficient to cover total costs.*[44]

GCA submits that there is no reason why the market-dominant ratemaking system, by itself, should be expected to "cover total costs." If the quoted statement means that all income – that from market-dominant rates together with revenue from competitive products and funds from other sources – did not add up to total costs, it is certainly unobjectionable. Particularly because the Commission also mentioned the Service's borrowing authority, clearly not part of the market-dominant ratemaking system, we believe that something like this was probably intended. Clarification, however, is definitely needed.

VIII. THE QUESTION OF LEGISLATION

A realistic approach to restoring the Postal Service's financial stability requires us to recognize that legislation with the same goal is a real possibility. We do not suggest that the Commission design its proposals on the assumption that currently pending legislation is certain to be enacted, and enacted in its present form.[45] On the other hand, a set of proposals which does not recognize that it may be, and do not provide clearly against needless, and harmful, duplication of financial rescue mechanisms is not a realistic one.

We take H.R. 756 in the present Congress as representative of what might happen. Sec. 207(a) of that bill provides that –

> (a) ESTABLISHMENT OF RATE BASELINE. – Notwithstanding any order of the Postal Regulatory Commission to the contrary –

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[44] Id., p. 169 (italics added).

[45] The Postal Service (*Comments of the United States Postal Service,* March 20, 2017, pp. 142 et seq.) cautioned against "refrain[ing] from reforming the price cap" in the hope that legislation would solve the problem. That is not the issue we are raising here.

> (1) no earlier than the first Sunday after the date of enactment of this Act, on a date selected by the Postmaster General in the exercise of the Postmaster General's unreviewable discretion, the Postal Service shall reinstate, as nearly as is practicable, 50 percent of the rate surcharge implemented under section 3622(d)(1)(F) (as redesignated by this Act) that was in effect on April 9, 2016; and
>
> (2) the partially reinstated surcharge reinstated pursuant to paragraph (1) shall be considered a part of the rate base for purposes of determining the percentage changes in rates when the Postal Service files a notice of rate adjustment.

If this provision were enacted, it would cause a permanent 2.15 percent increase in market-dominant rates.

The Commission has calculated that a two-percent increase lasting five years would adequately put the Postal Service "on the path" to medium-term financial stability, by recovering the $2.7 billion loss recorded for FY 2016.[46] Granting this for argument's sake, it follows that a 4.15 percent increase would be excessive. The Commission's proposal relies also on "cost reductions and operational efficiency gains" to be achieved by the Postal Service. But a revenue increase more than twice as large as the Commission considers appropriate would predictably blunt the incentive to realize those economies. This, in turn, raises substantial questions regarding the achievement of objective (b)(1).

It hardly needs emphasizing that such a large – and to a great extent permanent – increase in prices would also cast doubt on the Commission's assumption regarding market-dominant volumes. Order No. 4258 acknowledges that its "assumption of constant mail volumes results in revenue estimates the Commission reasonably anticipates

[46] See Order No. 4258, pp. 39 et seq.

will be higher than the revenues that the proposed rate adjustment authority would actually generate."[47] The assumption becomes even riskier – perhaps prohibitively so – if the additional revenue is more than twice what the Commission proposes as appropriate.

The Commission could avoid this trap by redesigning its supplemental rate authority proposal to include simple fail-safe mechanisms:

1) It could incorporate a provision that, if legislation incorporating a market-dominant rate increase is enacted before the Commission's new rules become effective, the two-percent, five-year supplemental rate authority will cease to be part of them[48]; and

2) It could also provide that if such legislation is enacted after the proposed supplemental rate authority is in effect, the legislated increase will take the place, pro tanto, of the supplemental authority.

CONCLUSIONS

Why GCA has focused on the December 1 Orders. Most of the preceding discussion has concentrated on relatively detailed issues arising from the Commission's proposed rule changes and the findings underpinning them. We have said less about some large-scale issues which the Commission evidently believes it has resolved, partly to keep these comments to a reasonable length, but principally because – as noted earlier – we discussed those issues extensively in our March 2017 comments on Order No. 3673. What we said then is still our position, and we respectfully ask that the Commission take notice of it.

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[47] Id., pp. 42-43.

[48] A possible refinement would be to provide that if a legislated permanent increase were less than the Commission's two percent, the supplemental rate authority would be scaled down accordingly. That refinement, if adopted, should take account of the difference between a permanent increase and one designed to last only five years.

Very recently, we have had the opportunity to read the early-filed comments of the American Mail Alliance (AMA), a participant representing a large number of business mailers.[49] Much of what AMA advances – particularly its persuasive showing that the market-dominant ratemaking system is not to blame for the Postal Service's financial challenges, and its suggestion that objective (b)(5) has been overemphasized, at the expense of other, coequal objectives – also reflects GCA's view. That said, it has seemed to us that our opportunity to comment would be better employed in focusing on important, and badly needed, changes to and clarifications of the proposed rules.

Summary – price cap issues. As regards the price cap, the most urgent issue is the near-total neglect, in the proposed changes, of the important benefit to Postal Service financial stability of the revenues, and contribution, of the growing competitive sector. The Commission treats this major factor in a footnote presenting an arbitrary, unexplained assumption that competitive contribution will remain unchanged for the next five years – an assumption starkly at odds with recent competitive product results.

Relatedly, the December 1 Orders leave it unclear whether the Commission has interpreted objective (b)(9) as requiring no more than production of the current sec. 3633(a)(3) minimum contribution. That construction violates an elementary canon of statutory interpretation: that a statute should not be construed so as to make some part of it redundant. Whether the minimum share is a positive quantity or is reduced to zero percent, the effect is to abolish any independent role for objective (b)(9). It is also inconsistent with the plain meaning of objective (b)(9), and would cause this statutory review to extend beyond the bounds which sec. 3622(d)(3) and the Commission's own Orders set for it. The Commission should reject what we called the "one-mechanism" interpretation, and make clear that objective (b)(9) requires independent attention to proper allocation of institutional costs, even if the minimum share then in effect is being provided.

[49] That GCA is not a signatory to this filing simply reflects the fact that, while the AMA comments speak for business mailers, GCA, as noted at the beginning of these Comments, brings a unique consumer perspective to the proceeding.

Summary – workshare discount issues. Here, we urge the Commission to make three improvements in its Order 4258 proposals:

- Make it clear that the proposed changes do away with the existing statutory exceptions (secs. 3622(e)(2)(A) – (D) and (3)), as well as creating fixed, time-limited tolerances for discounts exceeding or falling below avoided costs;
- Explicitly adopt what we have labeled the "ideal rate" method of constructing rates down the presort tree, to avoid situations in which the rate calculation arithmetic produces discounts falling outside the proposed bands; and
- Discard the proposal to make those bands symmetrical around avoided costs, and instead, in the interests of avoiding needless revenue loss for the Postal Service, allow greater tolerance for discounts falling below avoided cost than for those above it.

Other issues. Finally, we urge the Commission to make clear that in defining and examining financial stability, it will fully recognize that the financial condition of the *entire* Postal Service is the proper focus, that the contribution of competitive products must be fully reflected, and that the market-dominant ratemaking system alone cannot be expected to restore financial stability.

We also ask the Commission to recognize that postal reform legislation which includes definite provisions for market-dominant revenue increases is a realistic possibility, and to add fail-safe mechanisms to insure that if such legislation is enacted market-dominant mailers are not subjected to duplicative (legislated and administrative) rate hikes.

March 1, 2018

Respectfully submitted,

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APPENDIX A

COMPETITIVE PRODUCTS AND PRC ORDER 4258

The United States Postal Service's (USPS) financial position has been of an area of concern for years. Most recently, USPS posted a $2.7 billion deficit for FY 2017. In an effort to strengthen USPS financial stability, the Postal Regulatory Commission's (PRC) has proposed a supplemental rate increase of 5.7% for market dominant products over the next five years to recover these losses. PRC's recommendation relies solely on market dominant products to generate this additional revenue. However, a more reasonable means of generating $2.7 billion is to rely on financial contributions from both market dominant and competitive products.

The simple proposal by PRC has shortcomings. To illustrate the importance of competitive products in recovering the deficit, we created two scenarios to simulate the financial contributions of market dominant and competitive products in the next five years. Scenario 1 assumes the financial contributions to cover the deficit are proportional to the current shares of revenue of each segment. Under this scenario, market dominant products contribute an additional 4.1%. Scenario 2 takes into account competitive product growth over the next five years. Under this scenario, the market dominant products will need to increase by 2.1%.

Role of Competitive Products

While market dominant products have been declining, competitive products have been growing in both revenue and volume over the last five years. During the past five years, market dominant revenue declined by 10% but competitive products increased by 44%. (Table 1)

Table 1.

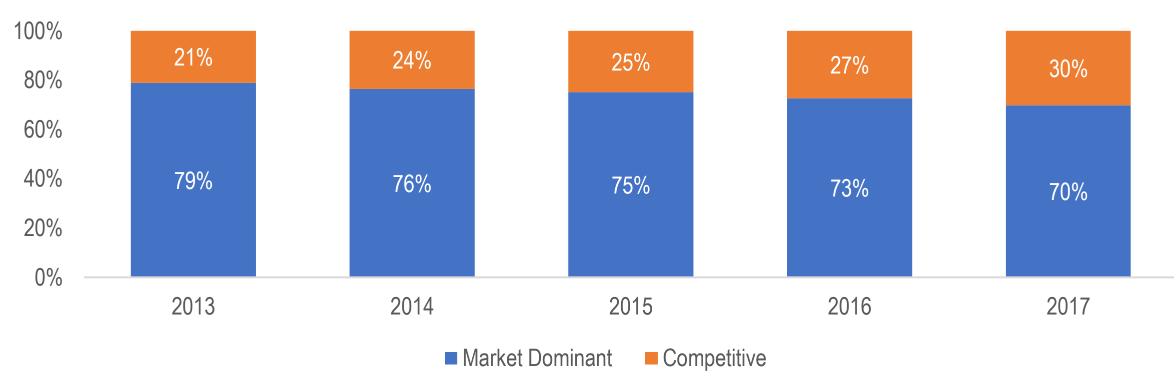
USPS Product Revenue and Volume 2013-17[50]

	2013	2014	2015	2016	2017	Change 2013-17
Revenue ($ millions)						
Market Dominant Mail	$51,254.9	$49,526.0	$49,703.9	$49,039.4	$45,969.2	-10%
Competitive Products	$13,740.7	$15,279.9	$16,427.8	$18,495.4	$19,830.4	44%
Total	$64,995.6	$64,805.9	$66,131.7	$67,534.8	$65,799.6	1%
Volume (millions)						
Market Dominant Mail	157,325.7	155,194.6	151,926.9	150,198.0	144,387.1	-8%
Competitive Products	2,533.2	3,107.8	3,448.0	3,958.4	5,103.6	101%
Total	159,858.9	158,302.4	155,374.9	154,156.4	149,490.6	-6%

In fact, competitive products have been increasingly important to USPS product revenue. The share of competitive products has increased nearly 43% within five years from 21% of product revenue in 2013 to 30% in 2017. (Figure 1)

Figure 1.

Market Dominant Mail and Competitive Products as a Percent of USPS Product Revenue, 2013-17[51]



50 PRC. Analysis of United States Postal Service Financial Results and 10-K Statement Reports, FY 2013-2016; USPS Revenue Pieces and Weight, 2017.

51 PRC Analysis of United States Postal Service Financial Results and 10-K Statement Reports, FY 2013-2016; USPS Revenue Pieces and Weight, 2017.

Revenue and volume are expected to continue growing in coming years. The USPS FY 2017 report to Congress states: "Revenue is planned to increase by $0.5 billion. This increase is driven entirely by increases in shipping and packages."[52] As a result, competitive products should be included in efforts to achieve financial stability.

USPS Financial Position and PRC Supplemental Rate Analysis

In Order 4258, the Postal Regulatory Commission (PRC) determined that a combination of 5.7% supplemental rate increase in market dominant products and rate adjustments for inflation allowed under the current price cap regulation is necessary to recover financial losses. Instead of instituting one steep rate increase, PRC proposes to spread it out over the course of five years.

The rationale of the supplemental increase suggested by PRC is as follows: market dominant mail and services generated $47.8 billion in revenue in 2017 and USPS realized $2.7 billion in losses. The PRC simply suggested that market dominant products must generate $50.5 billion in revenue ($47.8 billion + $2.7 billion), which is equal to a 5.7% increase in market dominant revenue, to solve the financial imbalances. Altogether, PRC proposes a total rate increase of 7.75% (5.7% the supplemental rate increase plus 2.05% the price cap allowance for inflation).[53] (Table 2)

Table 2.

Basic Reproduction of PRC Supplemental Rate Increase Analysis[54]

	2017 Revenue ($ millions)	Coverage of Deficit ($ millions)	Required Increase to Cover Deficit
Market Dominant	$47,761.0	$2,742.0	5.7%
Competitive	$19,830.4	$0.0	0.0%
Total	$67,591.4	$2,742.0	

Inclusion of Competitive Products in Analysis

In our view, the proposal of PRC is incomplete and ignores a large share of revenue from the competitive market. Competitive products should play a role in recovering a portion of these losses. We examine two scenarios: (1) we allocate the deficit proportionally between market dominant and competitive products, and (2) we examine the potential for competitive product growth over the next five years.

Scenario 1: Recovering Debt Proportionally with Revenue Contributions

If PRC sought to recover losses based on the proportion of revenue generated by market dominant and competitive products, it would reduce the burden on market dominant products, which already suffer

52 USPS. FY 2017 Report to Congress, p. 23.

53 BLS CPI-U projection used in PRC Order 4258.

54 PRC Order 4258; USPS. FY2017 Revenue Pieces and Weight; USPS. FY 2017 Annual Report to Congress.

from revenue and volume declines. In other words, market dominant mail and services would only be responsible for recovering 71% of $2.7 billion, and competitive products would recover 29%, based on 2017 revenue contributions. Market dominant mail and services would be responsible for recovering $1.9 billion, and competitive products would cover nearly $805 million. (Table 3)

Table 3.

Recovering 2017 Deficit Proportionate with Market Dominant and Competitive Product Revenue[55]

	2017 Revenue ($ millions)	Coverage of Deficit ($ millions)	Required Increase to Cover Deficit
Market Dominant (71%)	$47,761.0	$1,937.5	4.1%
Competitive (29%)	$19,830.4	$804.5	4.1%
Total	$67,591.4	$2,742.0	

In this scenario, a less severe supplemental rate increase would be needed to cover USPS losses. Seeing as the USPS already expects competitive products to drive revenue growth in coming years, no real change would be required in competitive products to achieve the required revenue growth.

Scenario 2: Recovering Debt Based on 5 Year Projected Growth in Competitive Products

As stated above, competitive products are expected to continue to grow and all additional revenue generated by the USPS is expected to come from this category. To think critically about solutions for recovering USPS debts, we examine the potential contribution of competitive products to USPS revenue and decompose it into contributions to attributable and institutional costs. Attributable costs cover the costs of providing the service itself, while institutional costs cover costs shared by all services including portions of workers compensation, transportation, supplies and services, and clerks and mail holders.

From 2012 to 2016, competitive product volume increased nearly 78%, and revenue increased nearly 62%. However, attributable costs did not increase proportionately with volume or revenue. In fact, total attributable costs only increased 49% during that period. With a higher increase in volume, this means that attributable costs per unit have been decreasing over time. The attributable cost of competitive products declined from 73% of total revenue in 2012 to 68% of total revenue in 2016. (Table 4).

[55] USPS. FY2017 Revenue Pieces and Weight; USPS. FY 2017 Annual Report to Congress.

Table 4.

Competitive Product Revenue and Attributable Cost 2012-16[56]

	2012	2013	2014	2015	2016	Change 2012-16
Volume	2,533.2	3,107.8	3,448.0	3,958.4	4,499.4	77.6%
Revenue	$11,425.9	$13,740.7	$15,279.9	$16,427.8	$18,495.4	61.9%
Attributable Cost	$8,383.2	$9,881.1	$10,970.0	$11,904.6	$12,490.4	49.0%
As % of Revenue	73%	72%	72%	72%	68%	

To conservatively project competitive product growth over the next five years, we make two assumptions: (1) competitive product revenue will increase at half of its historical annual average growth over the past five years, and (2) the share of attributable costs will remain constant. Over the past five years, competitive product revenue realized an average annual growth rate of 12.9%, in this projection we assume revenue will increase at an annual rate of approximately 6.4%. From 2012 to 2016, competitive products contributed an average of 71% of revenue to attributable costs, we apply this share of attributable costs to 2017 revenue, and to our projected revenue from 2018 to 2022.

The results of this projection show that competitive product revenue will increase in real terms (2017 dollars) by nearly $6 billion from 2018 to 2022, including an additional $1.7 billion in revenue after attributable costs. (Table 5)

Table 5.

Projected Competitive Product Revenue and Attributable Costs

	Actual	Projected					Change
	2017	2018	2019	2020	2021	2022	2018-22
Revenue *6.44% growth*	$19,830.4	$21,108.5	$22,468.9	$23,917.0	$25,458.5	$27,099.3	$5,990.8
Attributable Costs *71% of revenue*	$14,079.6	$14,987.0	$15,952.9	$16,981.1	$18,075.5	$19,240.5	$4,253.5
Institutional Costs *29% of revenue*	$5,750.8	$6,121.5	$6,516.0	$6,935.9	$7,383.0	$7,858.8	$1,737.3

56 PRC Analysis of United States Postal Service Financial Results and 10-K Statement Reports, FY 2013-2016; PRC. Annual Compliance Determination Report, FY 2012.

If PRC aims to cover $2.7 billion deficit over the next five years, this projection suggests that $1.7 billion could be covered by competitive products,[57] leaving $1.0 billion to be recovered though market dominant rate increases. This scenario results in a 2.1% increase in market dominant revenue to cover deficits. (Table 6)

Table 6.

Required Revenue Increase with Competitive Product Revenue Projection

	2017 Revenue ($ millions)	Coverage of Deficit ($ millions)	Required Increase to Cover Deficit
Market Dominant	$47,761.0	$1,004.7	2.1%
Competitive	$19,830.4	$1,737.3	8.8%
Total	$67,591.4	$2,742.0	

If PRC adds the inflation adjustment, the total rate increase would be 4.15% (2.1% + 2.05% inflation) compared to the proposed 7.75% by the PRC.

Conclusion

Effective financial stability strategies should include both market dominant and competitive products. Even a conservative projection of revenue would suggest that competitive products will be able to contribute significantly to recover losses, without drastically increasing rates for already declining market dominant products. From 2018 to 2022, competitive products are expected to increase $6 billion in real terms (2017 dollars), this would give an added contribution of $1.7 billion to institutional costs. If this additional contribution was allocated to cover the $2.7 billion USPS deficit, market dominant products would only need to cover the remaining $1.0 billion. This would translate into a 2.1% increase in revenue required from market dominant products or 4.15% after including inflation.

[57] Note: Institutional costs have remained fairly constant in the last few years. From 2013-2016, nominal institutional costs rose about 3% per year on average, which is just slightly higher than inflation, meaning that real institutional costs remained relatively flat. For simplicity, we assume that all additional revenue covering institutional costs are allocated to the $2.7 billion deficit.

References

Postal Regulatory Commission. Analysis of United States Postal Service Financial Results and 10-K Statement Reports, FY 2013.

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